Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 1 and 7

[Docket No. 95–34]

RIN 1557–AB37

Investment Securities

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is proposing to clarify and update its rules that prescribe the standards under which national banks may purchase, sell, deal in, and underwrite securities. This proposal is part of the OCC's Regulation Review Program, a project designed to review comprehensively, modernize and simplify OCC regulations and reduce unnecessary regulatory burdens. The proposed revisions reorganize the regulation by placing related subjects together, clarify areas where the rules are unclear and confusing, and update various provisions to address market developments and to incorporate significant OCC interpretations, judicial decisions and statutory amendments.

DATES: Comments must be received by February 20, 1996.

ADDRESSES: Comments should be directed to: Communications Division, 250 E Street, SW., Washington, DC 20219, Attention: Docket No. 95–34. Comments will be available for public inspection and photocopying at the same location. In addition, comments may be sent by facsimile transmission to FAX number 202/874–5274 or by electronic mail to REG.COMMENTS@OCC.TREAS.GOV.

FOR FURTHER INFORMATION CONTACT: Kay Bondehagen, Special Assistant to the Deputy Chief Counsel (202) 874–5200; Stuart Feldstein, Senior Attorney, Legislative and Regulatory Activities Division (202) 874–5090; Lee Walzer, Senior Attorney, Securities and Corporate Practices Division, (202) 874–5210; Lisa Lintecum, Director, Fiduciary Activities, (202) 874–5419.

SUPPLEMENTARY INFORMATION:

Background

OCC Regulation Review Program

The OCC is proposing to revise 12 CFR part 1 pursuant to its Regulation Review Program. Pursuant to this Program, the OCC is reviewing all its rules. Rules that are not necessary to protect against unacceptable risks, that do not support equitable access to banking services for all consumers or that are not needed to accomplish other statutory responsibilities of the OCC will be revised or eliminated.

Where risks are meaningful and regulation is appropriate, rules will be examined to determine if they achieve their purpose at the least possible cost. The OCC also recognizes that one source of regulatory cost is the failure of regulations to provide clear guidance because they are difficult to follow and understand. Therefore, an important component of the Regulation Review Program is to revise regulations, where appropriate, to improve clarity and better communicate the standards that the rules are intended to convey.

Investment Securities Limitations

Most of the limitations on the ability of national banks to purchase, sell, deal in, and underwrite securities trace to the Banking Act of 1933, Section 16, Public Law 73–66, 48 Stat. 184 (codified as amended at 12 U.S.C. 24 (Seventh) (1933)). More recently, the Secondary Mortgage Market Enhancement Act of 1984 (SMMEA)[1] and the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRI Act)[2] removed quantitative limits on national banks' purchases of certain types of mortgage- and small business-related securities, subject to any regulations prescribed by the OCC.

Although the OCC has revised part 1 a number of times since the early 1960s, the current version still contains many provisions dating from 1963. See 28 FR 9916 (1963). The OCC revised part 1 in 1971, adding the distinctions among ''Type I security,'' ''Type II security'' and ''Type III security.'' See 36 FR 6737 (1971). Guidelines were added to the part in 1982. See 47 FR 5701 (1982). The OCC revised part 1 again in 1989 principally to reflect amendments to 12 U.S.C. 24 (Seventh) by adding obligations of the African Development Bank and Inter-American Investment Corporation to the description of Type II securities. See 54 FR 1333 (1989). To reduce regulatory burden, the OCC also amended part 1 in 1993 to eliminate a requirement that a national bank maintain certain information for a specified period of time to demonstrate prudence in making determinations and carrying out securities transactions. See 58 FR 27443 (1993). The OCC tended to graft these changes onto the previous regulatory framework, resulting in a sometimes confusing combination of definitions and restrictions.

The OCC did not amend part 1 to reflect the statutory change resulting from the enactment of SMMEA in 1984. Nor have changes been made to the rule to reflect significant judicial decisions and interpretations of the OCC.

Proposal

This proposal modernizes the rules in part 1 and furthers the goals of the OCC's Regulation Review Program. In order to make part 1 more accessible and comprehensive, the proposal restructures many sections of the rule. The proposal also updates the rule to incorporate statutory changes to 12 U.S.C. 24 (Seventh), judicial decisions and long-standing OCC interpretations. The following discussion identifies and explains the significant proposed changes. The OCC requests comments on all aspects of this proposal, and, in addition, requests specific comments on certain changes that are highlighted. The OCC also welcomes any additional comments relevant to this proposal. A table summarizing the areas where changes are proposed is set forth at the end of this preamble.

Authority, purpose, and scope (section 1.1)

The proposal consolidates the current ''Scope and application'' section (§ 1.2) with the ''Authority'' section (§ 1.1). The sections are substantially condensed to eliminate redundant and unnecessary language.

The limitations set forth in part 1 apply to national banks, Federal branches of foreign banks, District of

[1] Sec. 105(c), Pub. L. 98–440, Title I, 98 Stat. 1691 (codified as amended at 12 U.S.C. 24 (Seventh) (1984)).

[2] Pub. L. 103–325, 108 Stat. 2160 (1994).

Columbia banks and state banks that are members of the Federal Reserve System.[3] This section further clarifies that foreign branches of national banks may be authorized to conduct additional international activities pursuant to 12 CFR part 211.

Definitions (section 1.2)

The proposal substantially revises the definitions section to add several definitions, updates others, and brings the definitions that currently appear in various places in the regulation into a single section. The following definitions have been added: ''investment company,'' ''Type IV security,'' and ''Type V security.'' The definitions of Type I, II, and III securities also have been substantially revised so that these types of securities are defined by their characteristics, not by the statutory limitations on the extent to which national banks may deal in, underwrite, purchase, or sell them. No substantive change in the authority of a national bank results from these revisions. In addition, as indicated with various individual definitions below, many definitions are revised to clarify their meaning and to incorporate the results of statutory changes, judicial decisions, and established OCC interpretations. Of particular note are the following proposed revisions:

Capital and surplus (section 1.2(a))

The proposal defines ''capital and surplus'' as Tier 1 and Tier 2 capital includable in risk-based capital under the Minimum Capital Ratios in 12 CFR part 3, plus the balance of a bank's allowance for loan and lease losses that is not included in Tier 2 capital. This is the same standard used in the OCC's recent revisions to its lending limit regulation. See 60 FR 8526 (February 15, 1995). As stated in the Preamble to the new lending limit rule, 60 FR 8528, the OCC's reasons for revising the definition of ''capital and surplus'' are to reduce the different definitions of capital currently used for various regulatory purposes and to use a well-recognized standard that banks are already required to calculate.

Investment grade (section 1.2(d))

''Investment grade'' means that a security is rated in one of the top four rating categories by each nationally recognized statistical rating organization that has rated the security. For example, if two nationally recognized statistical rating organizations rate the security in one of their top four categories, the security would qualify as ''investment grade'' even if other nationally recognized statistical rating organizations had not rated the security. However, if one of the two organizations rating the security did not rate the security in one of the top four categories, the security would not qualify as ''investment grade.'' Thus, when a security is given different ratings by different nationally recognized rating organizations, the lowest rating governs for purposes of this definition.

Investment security (section 1.2(e))

To be an ''investment security'' under the proposed definition, a security must be an investment grade marketable debt obligation or, if the security is not rated, it must be the credit equivalent of an investment grade marketable debt obligation. These standards reflect current OCC guidance and practice.

The OCC requests comments on whether the regulation should describe more specifically the characteristics of securities that are the ''credit equivalent of investment grade'' securities, and, if so, what description would be appropriate.

Commenters also are requested to address whether other securities with characteristics functionally equivalent to a debt obligation might be classified as an ''investment security.''

Marketable (section 1.2(f))

This proposed definition attempts to rely on more objective standards than the current definition of ''marketable.'' Currently, a marketable security is defined in § 1.5(a) as one that ''may be sold with reasonable promptness at a price which corresponds reasonably to its fair value.'' The proposed definition places more emphasis on indicators of a ready market for a security rather than a prediction of whether the security can be sold quickly at a particular price. As proposed, marketable securities include: (1) Securities registered under the Securities Act of 1933 (the Securities Act), 15 U.S.C. 77a *et seq.*; (2) certain government securities and municipal revenue bonds not required to be registered under the Securities Act; and (3) investment grade securities sold pursuant to SEC Rule 144A, 17 CFR 230.144A.

SEC Rule 144A provides a ''safe harbor'' exemption from the registration requirements of the Securities Act for resales of privately offered or ''restricted'' securities to qualified institutional buyers. The rationale for treating securities that qualify under SEC Rule 144A as readily marketable is that they may be sold without the need to prepare and receive SEC clearance of a registration statement used in connection with the sale. There may be a situation, however, based upon the particular security, when the security is not necessarily immediately sellable.

The OCC requests comments regarding whether this definition of ''marketable'' is sufficiently inclusive, particularly regarding other exemptions under the Securities Act, such as the statutory nonpublic offering exemption, that enable a seller to sell a security promptly at market or fair value, and whether the definition is appropriately inclusive of foreign sovereign debt.

The OCC also welcomes comments regarding alternative definitions of ''marketable'' that would address the OCC's concerns about liquidity. Commenters may suggest adopting a more general standard, or retaining the current standard whereby a security sold with reasonable promptness for a price that reasonably corresponds to its fair value is marketable. Commenters are asked to address how the OCC might objectively measure such a standard.

Type I security (section 1.2(h))

As in the current rule, the proposal defines a ''Type I'' security to mean specified government securities. The proposal also incorporates into the definition the key elements of the interpretation now found in § 1.110 regarding securities backed by the full faith and credit of the U.S. Government. The proposed definition is consistent with 12 U.S.C. 24 (Seventh), which does not require that government securities be ''marketable'' or otherwise qualify as ''investment securities.''

Type II security (section 1.2(i))

The proposal redefines a ''Type II'' security to mean an investment security that is issued by certain state, international or multilateral organizations, or that is otherwise listed or described in the statute. The definition differs from the current rule, which describes a Type II security both by the investment limits that apply to it, and by examples of qualifying types of issuers. The proposed definition also includes the statutory requirement that this type of security must qualify as an ''investment security,'' in addition to being issued by a qualifying type of issuer.

Type III security (section 1.2(j))

Part 1 currently defines a ''Type III'' security to mean a security that ''a bank may purchase and sell for its own

[3] State banks that are members of the Federal Reserve System are subject to the same limitations and conditions with respect to the purchasing, selling, underwriting and holding of investment securities and stock applicable to national banks under 12 U.S.C. 24 (Seventh). 12 U.S.C. 335.

account, subject to a 10 percent limitation, but may neither deal in nor underwrite.'' § 1.3(e). Instead of defining a Type III security in this manner, the proposal redefines a Type III security as an investment security that does not qualify as a Type I, II, IV, or V security. Examples of Type III securities include corporate bonds and municipal revenue bonds.

Commenters are asked to address whether other examples of Type III securities also should be specifically referenced in the regulation. In particular, commenters are asked to address whether foreign securities that are currently eligible for investment by foreign branches of U.S. banks should be included as Type III securities.

Type IV security (section 1.2(k))

The substance of a ''Type IV'' security was established, although not named ''Type IV,'' by amendments made to 12 U.S.C. 24 (Seventh) in 1984 by SMMEA and in 1994 by the RCDRI Act. The proposed definition tracks the statutory changes. SMMEA amended 12 U.S.C. 24 (Seventh) to permit national banks to purchase without limitation certain residential and commercial mortgage-related securities offered and sold pursuant to section 4(5) of the Securities Act, 15 U.S.C. 77d(5), or residential mortgage-related securities as defined in section 3(a)(41) of the Securities Exchange Act of 1934 (the Exchange Act), 15 U.S.C. 78c(a)(41). As previously noted, part 1 was never amended to incorporate this 1984 statutory revision. The RCDRI Act defined a new type of small business-related security in section 3(a)(53)(A) of the Exchange Act, 15 U.S.C. 78c(a)(53)(A), and added a class of commercial mortgage-related securities to section 3(a)(41) of the Exchange Act, 15 U.S.C. 78c(a)(41).

The amendments to 12 U.S.C. 24 (Seventh) made by the RCDRI Act removed limitations on purchases by national banks of certain small business-related and commercial mortgage-related securities. The amendments provide the OCC authority to prescribe regulations to ensure that acquisitions of such securities are conducted in a manner consistent with safe and sound banking practices. The OCC has concerns that undue concentration of risk could arise if a bank invested in a security backed by a small number of loans or where one or a small number of loans represented a large percentage of the assets in the pool. This type of concentration of risk is more likely to arise with respect to commercial mortgage- and small business-related securities than with respect to residential mortgage-related securities. For this reason, the proposal requires a Type IV security that is small business- or commercial mortgage-related be fully secured by interests in a pool of homogeneous loans of numerous obligors. The definitions of a Type IV small business-related security and a commercial mortgage-related security also require that the aggregate amount of collateral from loans of any one obligor not exceed 5 percent of the total amount of collateral for the security when the security is issued, in order to assure diversification.

In some instances, such as the prepayment of underlying loans, an issuer or trustee may have the legal right to substitute collateral. If the issuer or trustee has the legal right to substitute collateral, the diversification requirement applies whenever the issuer or trustee substitutes collateral throughout the term of an issue, rather than merely at issuance.

Where the issuer or trustee does not have the legal right to substitute collateral or elects not to exercise the right, the diversification requirement applies only at issuance. If the diversification requirement applied throughout the term of an issue without ongoing substitution of collateral, prepayment of loans in the pool would reduce the number of loans that serve as collateral for the security and, at some point, the aggregate amount of collateral from loans of one obligor could exceed the proposed 5 percent limit and result in a violation of the regulation. Such a result would have the unintended consequence of deterring potential issuers from securitizing existing collateral.

The OCC requests comments on whether the term ''homogeneous loans'' should be specifically defined. The OCC also welcomes comments on whether the proposed requirement for certain Type IV and all Type V securities, that the aggregate amount of collateral from loans of any one obligor may not exceed 5 percent of the total amount of collateral for that security, or some other standard, would be appropriate to assure adequate diversification of the collateral.

Type V security (Section 1.2(l))

The proposal adds a definition of ''Type V security'' in order to address separately investment grade securities that represent interests in assets a national bank may invest in directly. The definition reflects the OCC's long-standing interpretations that in addition to the investments specifically described in 12 U.S.C. 24 (Seventh), national banks may hold securitized forms of assets in which they may invest directly.[4] In order to assure the high quality of this type of asset-backed security, however, the definition requires that Type V securities be rated investment grade. The practical effect of the definition is that Type V securities are recognized as high quality indirect interests in assets in which a national bank could invest directly.

A Type V security also must be fully secured by interests in a pool of homogeneous loans to numerous obligors. The definition requires a pool of loans homogeneous as to type of loan, term of loan, or other distinguishing characteristics, in order to facilitate performance projections based on the common features of loans in the pool. As an added safeguard to assure diversification of the collateral supporting the security, the definition requires that the aggregate amount of collateral from loans of any one obligor not exceed 5 percent of the total amount of collateral for the security. Like the similar requirement for Type IV securities, this diversification requirement applies throughout the term of the issue only if the issuer exercises a legal right to substitute collateral.

Commenters are invited to address whether these standards, which also apply to certain Type IV securities, are appropriate.

Limitations on dealing in, underwriting, and purchasing and selling securities (Section 1.3)

The proposal consolidates into one section the provisions regarding limitations on dealing in, underwriting, purchasing, and selling different types of securities. Proposed § 1.3 incorporates portions of current §§ 1.4, ''Type I securities; standards for authorized transactions;'' 1.5(b), ''Judgment based predominantly upon

[4] Interpretive Letter No. 362 (May 22, 1986), reprinted in [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,532 (bonds collateralized by mortgages); Interpretive Letter No. 388 (June 16, 1987), reprinted in [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,612 (mortgage-backed pass-through certificates); Interpretive Letter No. 416 (February 16, 1988), reprinted in [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,640 (securitized automobile loans); Investment Securities Letter No. 29 (August 3, 1988), reprinted in [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,899 (investment limits for asset-backed securities consisting of GMAC receivables); Interpretive Letter No. 514 (May 5, 1990), reprinted in [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,218 (securitized mortgages); Interpretive Letter No. 540 (December 12, 1990), reprinted in [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,252 (securitized credit card receivables); *Security Pacific* v. *Clarke*, 885 F.2d 1034 (2d Cir. 1989), *cert. denied*, 493 U.S. 1070 (1990) (national bank authority to securitize assets).

reliable estimates;'' 1.6, ''Type II securities; authority to deal in and underwrite;'' and 1.7, ''Types II and III securities; limitations on holdings.'' Current § 1.7(c), ''Limitations prescribed in eligibility rulings,'' has been removed as unnecessary. Current references to ''prudent banking judgment'' have been changed to ''safe and sound banking practices.'' The latter change is consistent with the OCC's implementation of this requirement and is not intended to change the applicable standard. Most of the limitations on Type I, II, III, and IV securities reflected in this section are derived from 12 U.S.C. 24 (Seventh).

In the proposal, the limitations with respect to Types II, III, and V securities are expressed in terms of ''the aggregate par value of the obligations of any one obligor,'' which is essentially the current approach. The OCC requests comments on whether this is an appropriate measure and, if not, whether alternative measures would be preferable.

Type II and III securities; other investment securities limitations (Section 1.3(d))

As in current § 1.7, the proposal provides that a national bank may not hold Type II and III securities of any one obligor that have a combined aggregate par value exceeding 10 percent of the bank's capital and surplus. However, aggregation is not required with respect to industrial development bonds. Instead, the 10 percent limitation applies separately to each security issue of a single obligor when the proceeds of that issuance are to be used to acquire and lease real estate and related facilities to economically and legally separate industrial tenants, and the issuance is payable solely from and secured by a first lien on the revenues to be derived from rentals paid by the lessee under net noncancellable leases. This provision incorporates the substance of the interpretation that currently appears at 12 CFR 7.7570. The OCC proposes to remove § 7.7570 in conjunction with this change.

Type IV securities (Section 1.3.(e))

The new section describing eligible Type IV securities confirms the authority granted to national banks by SMMEA and the RCDRI Act to purchase and sell certain mortgage- and small business-related securities. The section also reflects OCC interpretations concerning the authority of a national bank to deal in obligations that are fully secured by Type I securities, in which national banks may deal.[5] These interpretations reflect the OCC's consistent approach of looking to the substance of an instrument, and not just its form, to determine the activities a bank may conduct in connection with the instrument. In the case of Type IV securities that are fully secured by Type I securities, the ultimate source of repayment is Type I securities. The proposal does not limit the categories of Type IV securities in which banks may deal, provided that the securities are collateralized by Type I securities. Thus, a bank's authority to deal in the securities under this part would be determined with reference to the standards that apply to Type I securities. (The ability of a bank to securitize and sell its loans, including loans that qualify as collateral for Type IV securities, is addressed in § 1.3(g).)

Type V securities (Section 1.3(f))

The proposal establishes a quantitative concentration limitation of 15 percent of a bank's capital and surplus for purchases and sales of Type V securities of any one obligor (or certain related obligors), rather than the 10 percent limit that the OCC currently applies to asset-backed securities that qualify as Type III securities. The OCC believes this approach is appropriate because: (1) The 15 percent standard is the same level used for the basic lending limit threshold; (2) the qualitative standards for a Type V security have been tightened, so that Type V securities are a high quality type of asset-backed security; and (3) under certain circumstances set forth in § 1.4(c), holdings of Type V securities of different issuers will be aggregated for purposes of calculating compliance with the 15 percent limitation. Therefore, the OCC believes an investment limitation of 15 percent of a bank's capital and surplus should not present undue investment or concentration risk.

The OCC solicits comments on whether a higher investment limitation, such as 25 percent of a bank's capital and surplus, would be sufficient to prevent excessive concentration.

Asset securitization (Section 1.3(g))

This new section reflects the OCC's established position that national banks may securitize and sell their loan assets. The ability of banks to sell conventional bank assets through the issuance and sale of certificates evidencing interests in pools of the assets provides flexibility that can enhance banks' safety and soundness.[6] Asset securitization provides an important source of liquidity by allowing banks to convert relatively illiquid assets into instruments with maturities and other features that investors are readily willing to purchase. Another important benefit is the increased credit available, due to the fact that a bank may make more loans with a given level of capital (when the assets are removed from the bank's balance sheet) and may diversify its lending into new markets without incurring undue risk. Also, a bank is less dependent on deposits to fund its loans, improving bank profitability, with positive implications for reducing bank failure rates and minimizing draws on the deposit insurance funds. The treatment described in the proposal reflects the OCC's long-standing treatment of national banks' asset sales activities as affirmed by case law.[7]

[5] See Interpretive Letter No. 514 (May 5, 1990), reprinted in [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,218; Interpretive Letter No. 362 (May 22, 1986), reprinted in [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,532.

[6] See, e.g., Remarks by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System before the American Bankers Association (October 8, 1994). See also Statement by Donald G. Coonley, Chief National Bank Examiner, OCC, Asset Securitization and Secondary Markets: Hearings Before the Subcomm. on Policy, Research, and Insurance of the Comm. on Banking, Finance and Urban Affairs, 102d Cong., 1st Sess. 2–4 (1991), reprinted in OCC Quarterly Journal (December 1991); and Joint Statement by Richard Spillenkothen, Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, and Donald H. Wilson, Financial Markets Officer, Federal Reserve Bank of Chicago, Secondary Market for Commercial Real Estate Loans: Hearings Before the Subcomm. on Policy, Research, and Insurance of the Comm. on Banking, Finance and Urban Affairs, 102d Cong., 2d Sess. 16–19 (1992), reprinted in 78 Fed. Res. Bull. 492 (1992).

[7] See, e.g., Interpretive Letter No. 585 (June 8, 1992), reprinted in [1992–1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,406 (securitized motor vehicle retail installment sales contracts purchased from automobile dealers); Interpretive Letter No. 540 (December 12, 1990), reprinted in [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,252 (securitized credit card receivables originated by bank or purchased from others); Interpretive Letter No. 514 (May 5, 1990), reprinted in [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,218 (securitized mortgages); Interpretive Letter No. 416 (February 16, 1988), reprinted in [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,640 (securitized automobile loans); Interpretive Letter No. 388 (June 16, 1987), reprinted in [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,612 (sale of mortgage-backed pass-through certificates); No Objection Letter No. 87–9 (December 16, 1987), reprinted in [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,038(securitization of commercial loans originated by the bank); Interpretive Letter No. 362 (May 22, 1986), reprinted in [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,532 (sales of bonds collateralized by mortgages). Regarding sales of participations in pools of loans, see Letter from Billy C. Wood, Deputy Comptroller, Multinational Banking (May 29, 1981), reprinted in [1981–82 Transfer Binder] Fed. Banking L. Rep. (CCH)

Continued

Investment company shares (Section 1.3(h))

The proposal permits a national bank to purchase and sell for its own account shares of a registered investment company, subject to two requirements: First, the investment company's portfolio must be comprised entirely of assets in which the bank could invest directly. Second, the amount of the bank's investment in shares of any one investment company is subject to the most stringent investment limitations applicable to the underlying securities and loans that comprise that investment company's portfolio. This provision incorporates OCC interpretations concerning the authority of a national bank to hold instruments representing indirect interests in assets that the bank could invest in directly. See Banking Circular 220 (November 21, 1986); An Examiner's Guide to Investment Products and Practices at 23 (December 1992).[8]

The OCC seeks comments on whether the definition of ''investment company'' should be revised to include limited partnerships with fewer than 100 investors, i.e., a partnership that would not qualify as an investment company within the meaning of section 3(c)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-3(c)(1), provided that the partnerships' portfolios consist solely of Type I securities that the bank may purchase and sell for its own account.

Securities held based on estimates of obligor's performance (Section 1.3(i))

Notwithstanding the general definition of an investment security (§ 1.2(e)), the proposal retains the flexibility contained in the current rule, for a bank to treat certain debt securities as investment securities when the bank concludes, on the basis of estimates that the bank reasonably believes are reliable, that the obligor will be able to meet its obligations under that security. The bank may not hold securities classified as investment securities solely in reliance on projections of an obligor's future performance that in the aggregate exceed 5 percent of the bank's capital and surplus. The bank must also believe that the security may be sold with reasonable promptness at a price which corresponds reasonably to its fair value. This approach is modeled upon the OCC's current rule, which allows banks an additional degree of flexibility to determine the quality of debt obligations, for a limited portion of the bank's investment portfolio. The OCC notes that securities representing interests in loans made for community development purposes are one type of security that could, depending upon their characteristics, be eligible for investment by national banks under this standard.

The OCC requests comments as to whether it should provide further clarification of the standards applicable to securities held based on estimates of obligor's performance and, if so, in what respects clarification is needed.

Calculation of limits (Section1.4)

Proposed § 1.4 is new. Paragraphs (a) and (b), relating to the calculation date and authority to require more frequent calculations, are modeled on provisions contained in the OCC's new lending limit regulation. As explained in connection with the lending limit rule, the provision reduces regulatory burden by allowing banks to rely on information they already collect for their Call Reports to calculate compliance with their lending limits. The same reasoning applies to calculating limits of banks' securities holdings, and the proposal achieves a consistent approach in those two areas.

Calculation of Type III and Type V securities holdings (Section 1.4(c))

This proposed paragraph is a new approach to investment securities limitations designed to address situations where a bank's investments in securities of different issuers present similar sources of risk, and, therefore, warrant aggregation. In calculating the amount of its investment in Type III or Type V securities, the proposal requires a bank to combine obligations of issuers that are related directly or indirectly through common control and securities that are credit-enhanced by the same entity. These aggregation rules, which result in a bank being treated as if it has a greater investment in the securities of one obligor than would otherwise be the case, apply separately to Type III and Type V securities held by a bank. Current OCC policies already apply comparable standards for aggregation of Type III securities. As applied to Type V securities, the aggregation rules provide important safeguards in connection with the 15 percent limit provided for investments in Type V securities. Thus, banks are given more investment flexibility with Type V securities, but the increased investment authority is subject to explicit safeguards to address risk concentrations.

Comment is invited regarding other bases upon which a bank should combine its holdings when calculating its investment in Type III or Type V securities of any one obligor. Specifically, the OCC seeks comments as to whether a bank should combine obligations that are predominately collateralized by loans made by the same originator or by originators that are related directly or indirectly through common control. In addition, commenters are asked to address whether and under what circumstances an issuer or affiliate of the issuer would provide a guarantee or other form of credit enhancement for Type V securities that could be a source of credit exposure of the investing bank to the issuer or its affiliate. Comment is also invited on whether the 15 percent investment limitation or a lower limitation is appropriate under these circumstances.

The OCC is not at this time proposing to apply an aggregate limit to a bank's combined holdings of Type III and Type V securities, but requests commenters to address whether some form of an aggregate limitation should apply to a bank's exposure to a single obligor, regardless of the type of the obligation. For example, under the proposal, a bank could invest in Type V securities of any one obligor in an amount not exceeding 15 percent of the bank's capital and surplus, and Type III securities of the same obligor in an amount not exceeding 10 percent of the bank's capital and surplus. In addition, under the lending limit rules, the bank could also make loans to the same obligor in an amount up to 15 percent—or 25 percent depending upon the collateral—of the bank's capital and surplus. Of course, the OCC retains the ability to take action in connection with concentrations inconsistent with safe and sound banking practices.

¶ 85,275; Letter from Paul M. Homan, Senior Deputy Comptroller for Bank Supervision (February 1, 1980), reprinted in [1981–82 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,213; Letter from John M. Miller, Deputy Chief Counsel (July 31, 1979), reprinted in [1978–79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,182; Letter from Paul M. Homan, Senior Deputy Comptroller for Bank Supervision (April 20, 1979), reprinted in [1978–79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,167; Letter from H. Joe Selby, Deputy Comptroller for Operations (October 17, 1978), reprinted in [1978–79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,144; Letter from John G. Heimann, Comptroller of the Currency (May 18, 1978), reprinted in [1978–79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,116; Letter from Charles B. Hall, Deputy Comptroller for Banking Operations (February 14, 1978), reprinted in [1978–79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,100; Letter from Robert Bloom, Acting Comptroller of the Currency (March 30, 1977), reprinted in [1973–78 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 97,093. Regarding national bank authority to securitize assets, see Security Pacific v. Clarke, 885 F.2d 1034 (2d Cir. 1989), cert. denied, 493 U.S. 1070 (1990).

[8] The Federal Reserve Board has adopted a similar interpretation relating to state member banks' investments in mutual funds that invest only in eligible securities. See 12 CFR 208.124.

Calculation of investment company holdings (section 1.4(d))

In calculating the amount of its investment in investment company shares under this proposal, a bank must use reasonable efforts to calculate and combine its pro rata share of a particular security in the portfolios of each investment company with the bank's direct holdings of securities of that issuer.

Safe and sound banking practices; credit information required (Section 1.5)

The requirement of ''prudent banking judgment'' in current § 1.8 is moved to § 1.5 and changed to require banks to adhere to ''safe and sound banking practices,'' in addition to any specific requirements of part 1. The OCC will continue its supervision of national bank investment securities activities, including those activities covered by the changes to part 1, to ensure that these investments are effected in a safe and sound manner. In recognition of the different types of risks that may affect the quality of a security, the proposal reflects the OCC position that safe and sound banking practices entail appropriate consideration of the market, interest rate, liquidity, legal, and operations and systems risks, as well as credit risk, posed by certain types of securities investments.[9] These standards are made clearly applicable to all types of permissible securities activities and holdings described in § 1.3. This change also makes the language of part 1 consistent with the authority of a federal banking agency to institute a cease-and-desist proceeding against an insured depository institution that has engaged or is about to engage in an ''unsafe and unsound practice.'' 12 U.S.C. 1818(b). The ''unsafe and unsound practice'' standard is well recognized by the courts. See, *e.g., Northwest National Bank, Fayetteville, Arkansas* v. *U.S. Department of the Treasury, Office of the Comptroller of the Currency,* 917 F.2d 1111 (8th Cir. 1990); *Gulf Federal Savings and Loan* v. *Federal Home Loan Bank Board,* 651 F.2d 259 (5th Cir.. 1981), *cert. denied,* 458 U.S. 1121 (1982); *Groos National Bank* v. *Comptroller of the Currency,* 573 F.2d 889 (5th Cir. 1978). The proposed section also gives banks additional flexibility in maintenance of records for examination purposes.

Convertible securities (section 1.6)

Proposed § 1.6 revises current § 1.9 to clarify the restrictions on investment in certain convertible securities and how banks must account for securities that are convertible into stock or have stock purchase warrants attached.

Securities held in satisfaction of debts previously contracted; holding period; disposal; accounting treatment; non-speculative purpose (section 1.7)

Proposed § 1.7 contains new information in paragraphs (b) ''holding period,'' (c) ''accounting treatment,'' and (d) ''non-speculative purpose,'' which embody standards consistent with OCC's Other Real Estate Owned regulation, see 58 FR 46529 (September 2, 1993), and the OCC's related interpretation, see Interpretive Letter No. 604 (October 8, 1992). A national bank holding securities in satisfaction of debts previously contracted may do so for a period of five years from the date that ownership of the securities was originally transferred to the bank, plus an additional five years, if permitted by the OCC.

Nonconforming investments (section 1.8)

This new section clarifies that a bank does not violate an applicable investment limitation when an investment in securities that was legal when made becomes nonconforming as a result of any of certain enumerated events, provided the bank exercises reasonable efforts to bring the investment into conformity with applicable limitations. The events included in the regulation are: A decline in the bank's capital; a merger of obligors, issuers, or credit-enhancers; issuers becoming related directly or indirectly related through common control; deterioration in the quality of a security so that the security is no longer an investment security; the substitution of collateral by an issuer or trustee that causes a Type IV or Type V security no longer to conform to the diversification requirements of §§ 1.2(k)(1) and (2) and 1.2(l); a change in the investment securities limitations rules; or other events identified by the OCC. This approach to nonconforming holdings is based upon the approach contained in the OCC's new lending limit regulation.

Commenters are specifically asked to address whether: (1) The phrase ''reasonable efforts'' needs additional clarification, and if so, how it might be defined or should be documented for the purposes of this section; (2) the OCC should require a bank to make ''reasonable efforts'' to bring into conformity an investment where the quality of a security deteriorates so that the security is no longer an investment security; and (3) any other events should be added to the list of circumstances that may cause an investment in securities to become nonconforming.

Amortization of premiums (current section 1.10)

Current § 1.10 is removed. The OCC believes the section is no longer necessary because generally accepted accounting principles (GAAP) appropriately govern the treatment of premiums. GAAP requires that a bank defer recognition of a premium paid for an investment security and amortize the premium over the period to maturity of the security. In contrast, current § 1.10 permits a bank to charge off the entire premium at the time of purchase or to amortize the premium in any manner the bank considers appropriate as long as the premium is extinguished entirely at or before the maturity of the security.

Interpretations

Indirect general obligations (section 1.100)

Proposed § 1.100 is derived from current § 1.120, but clarifies and shortens the text. Current paragraphs (f) ''Tax anticipation notes,'' and (g) ''Bond anticipation notes'' of § 1.120 are removed as unnecessary.

Eligibility of securities for purchase, dealing in, and underwriting by national banks; general guidelines (current section 1.100)

The proposal removes current § 1.100, which contains introductory and explanatory comments that the OCC believes are unnecessary in light of other proposed changes to part 1.

Taxing powers of a State or a political subdivision (section 1.110)

Section 1.110 is a shortened version of current § 1.130, with portions removed that are no longer necessary. New text is added to provide standards for determining when obligations that are expressly or implicitly dependent upon voter or legislative authorization of appropriations are considered supported by the full faith and credit of a State or political subdivision.

Prerefunded or escrowed bonds and obligations secured by Type I securities (section 1.120)

Proposed § 1.120 is derived from current § 1.120(e).

Type II securities; guidelines for obligations issued for university and housing purposes (section 1.130)

Proposed § 1.130 is a streamlined version of current § 1.140, and also clarifies the types of issuers whose

[9] See OCC Banking Circular 277, reprinted in 5 Fed. Banking L. Rep. (CCH) ¶ 58,717 (October 27, 1993).

obligations qualify as Type II securities. Current § 1.140(c)(1) and portions of (c)(2) have been removed. See Proposed § 1.130(c).

The OCC welcomes comments on any aspect of the proposed regulation, particularly, those issues specifically noted in this preamble.

DERIVATION TABLE

[Only Substantive Modifications, Additions and Changes are Indicated]

Revised provision	Original provision	Comments
§ 1.1	§§ 1.1, 1.2	Modified.
§ 1.2(a)		Added.
§ 1.2(b)	§ 1.3(g)	Modified.
§ 1.2(c)		Added.
§ 1.2(d)		Added.
§ 1.2(e)	§ 1.3(b)	Modified.
§ 1.2(f)	§ 1.5(a)	Significant change.
§ 1.2(g)	§ 1.3(f)	
§ 1.2(h)	§§ 1.3(c), 1.110	Modified.
§ 1.2(i)	1.3(d)	Modified.
§ 1.2(j)	§ 1.3(e)	Modified.
§ 1.2(k)		Added.
§ 1.2(l)		Added.
	§ 1.3(a)	Removed.
§ 1.3(a)	§ 1.4	Modified.
§ 1.3(b)	§§ 1.3(d), 1.6, 1.7(a)	Modified.
§ 1.3(c)	§§ 1.3(e), 1.7(a)	Modified.
§ 1.3(d)	§ 1.7(a), 12 CFR 7.7570	Modified.
§ 1.3(e)		Added.
§ 1.3(f)		Added.
§ 1.3(g)		Added.
§ 1.3(h)		Added.
§ 1.3(i)	§§ 1.5(b), 1.7(b)	Modified.
§ 1.4		Added.
§ 1.5	§ 1.8	Significant change.
§ 1.6	§ 1.9	Modified.
§ 1.7(a)	§ 1.11	
§ 1.7(b)		Added.
	§ 1.7(c)	Removed.
	§ 1.7(d)	Added.
§ 1.7(c)		Added.
§ 1.8		Added.
	§ 1.10	Removed.
	§ 1.100	Removed.
§ 1.100(a)	§ 1.120	
§ 1.100(b)(1)	§ 1.120(a)	
§ 1.100(b)(2)	§ 1.120(b)	
§ 1.100(b)(3)	§ 1.120(c)	
§ 1.100(b)(4)	§ 1.120(d)	
§ 1.110	§ 1.130	Modified.
	§ 1.120(f)	Removed.
	§ 1.120(g)	Removed.
§ 1.120	§ 1.120(e)	
§ 1.130(a)	§ 1.140(a)	Modified.
§ 1.130(b)	§ 1.140(b)	
§ 1.130(c)	§ 1.140(c)	Modified.

Regulatory Flexibility Act

It is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. This regulation will reduce the regulatory burden on national banks, regardless of size, by simplifying and clarifying existing regulatory requirements.

Paperwork Reduction Act of 1995

The OCC invites comment on:

(1) Whether the proposed collection of information contained in this notice of proposed rulemaking is necessary for the proper performance of OCC functions, including whether the information has practical utility;

(2) The accuracy of the estimate of the burden of the proposed information collection;

(3) Ways to enhance the quality, utility, and clarity of the information to be collected; and

(4) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology.

Respondents/recordkeepers are not required to respond to this collection of information unless it displays a currently valid OMB control number.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on

the collections of information should be sent to the Office of Management and Budget, Paperwork Reduction Project (1557), Washington, DC 20503, with copies to the Legislative and Regulatory Activities Division (1557), Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

The collection of information requirements in this proposed rule are found in 12 CFR 1.6 and 1.7. This information is required to evidence compliance with statutory limitations on the quantity and type of investments by national banks. The likely respondents/recordkeepers are national banks.

Estimated average annual burden hours per respondent/recordkeeper: 2 hours.

Estimated number of respondents and/or recordkeepers: 3,000.

Estimated total annual reporting and recordkeeping burden: 6,000 hours.

Start-up costs to respondents: None.

Records are to be maintained for life of the investment.

Executive Order 12866

The OCC has determined that this proposal is not a significant regulatory action.

Unfunded Mandates Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995 (Unfunded Mandates Act) (signed into law on March 22, 1995) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, Section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. Because the OCC has determined that the proposed rule will not result in expenditures by State, local, and tribal governments or by the private sector of $100 million or more in any one year, the OCC has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered. Nevertheless, as discussed in the preamble, the rule has the effect of reducing burden and increasing the discretion of national banks regarding their sound investment activities.

List of Subjects

12 CFR Part 1

Banks, banking, National banks, Reporting and recordkeeping requirements, Securities.

12 CFR Part 7

Credit, Insurance, Investments, National banks, Reporting and recordkeeping requirements, Securities, Surety bonds.

Authority and Issuance

For the reasons set out in the preamble, chapter I of title 12 of the Code of Federal Regulations is proposed to be amended as set forth below:

1. Part 1 is revised to read as follows:

PART 1—INVESTMENT SECURITIES REGULATION

Sec.

Authority: 12 U.S.C. 1 *et seq.*, 24 (Seventh), and 93a.

§ 1.1 Authority, purpose, and scope.

(a) *Authority.* This part is issued pursuant to 12 U.S.C. 1 *et seq.*, 12 U.S.C. 24 (Seventh), and 12 U.S.C. 93a.

(b) *Purpose.* This part prescribes standards under which national banks may purchase, sell, deal in, underwrite, and hold securities, consistent with the authority contained in 12 U.S.C. 24 (Seventh) and safe and sound banking practices.

(c) *Scope.* The standards set forth in this part apply to national banks, District of Columbia banks, and federal branches of foreign banks. Further, pursuant to 12 U.S.C. 335, State banks that are members of the Federal Reserve System are subject to the same limitations and conditions that apply to national banks in connection with purchasing, selling, dealing in, and underwriting securities and stock. In addition to activities authorized under this part, foreign branches of national banks also may be authorized to conduct international activities pursuant to part 211 of this title.

§ 1.2 Definitions.

(a) *Capital and surplus* means:

(1) A bank's Tier 1 and Tier 2 capital included in the bank's risk-based capital under the OCC's Minimum Capital Ratios in Appendix A to part 3 of this chapter based upon the bank's Consolidated Report of Condition and Income filed under 12 U.S.C. 1817(a)(3); plus

(2) The balance of a bank's allowance for loan and lease losses not included in the bank's Tier 2 capital, for purposes of the calculation of risk-based capital under 12 CFR part 3, based upon the bank's Consolidated Report of Condition and Income filed under 12 U.S.C. 1817(a)(3).

(b) *General obligation of a State or political subdivision means:*

(1) An obligation supported by the full faith and credit of an obligor possessing general powers of taxation, including property taxation; or

(2) An obligation payable from a special fund or by an obligor not possessing general powers of taxation, when an obligor possessing general powers of taxation, including property taxation, has unconditionally promised to make payments into the fund or otherwise provide funds to cover all required payments on the obligation.

(c) *Investment company* means an investment company, including a mutual fund, registered under section 8 of the Investment Company Act of 1940, 15 U.S.C. 80a-8.

(d) *Investment grade* means a security rated investment grade (in one of the top four rating categories) by each nationally recognized statistical rating organization that has rated the security.

(e) *Investment security* means a marketable debt obligation that is not predominantly speculative in nature. A security is not predominantly speculative in nature if it is rated investment grade. When a security is not rated, the security must be the credit equivalent of securities rated investment grade.

(f) *Marketable* means that the security is:

(1) Registered under the Securities Act of 1933, 15 U.S.C. 77a *et seq.;*

(2) Exempt from registration under the Securities Act of 1933, 15 U.S.C. 77c, and authorized under 12 U.S.C. 24 (Seventh) as eligible for investment without limitation by a national bank, such as a security issued or guaranteed by:

(i) The United States or a territory thereof;

(ii) The District of Columbia;

(iii) A State of the United States;

(iv) A political subdivision of a State or territory;

(v) A public instrumentality of one or more States or territories; or

(vi) A person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States;

(3) A municipal revenue bond exempt from registration under the Securities Act of 1933, 15 U.S.C. 77c(a)(2); or

(4) Offered and sold pursuant to Securities and Exchange Commission Rule 144A, 17 CFR 230.144A, and rated investment grade.

(g) *Political subdivision* means a county, city, town, or other municipal corporation, a public authority, and generally any publicly-owned entity that is an instrumentality of a State or of a municipal corporation.

(h) *Type I security* means:

(1) Obligations of the United States;

(2) Obligations issued, insured, or guaranteed by a department or an agency of the United States Government, if the obligation, insurance or guarantee commits the full faith and credit of the United States for the repayment of the obligation;

(3) Obligations issued by a department or agency of the United States, or an agency or political subdivision of a State of the United States, that represent an interest in a loan or a pool of loans made to third parties, if the full faith and credit of the United States has been validly pledged for the full and timely payment of interest on, and principal of, the loans in the event of non-payment by the third party obligor(s);

(4) General obligations of a State of the United States or any political subdivision;

(5) Obligations authorized under 12 U.S.C. 24 (Seventh) as permissible for a national bank to deal in, underwrite, purchase, and sell for the bank's own account; and

(6) Other securities the OCC deems eligible as Type I securities in accordance with 12 U.S.C. 24 (Seventh).

(i) *Type II security* means an investment security that represents:

(1) Obligations issued by a State, or a political subdivision or agency of a State, for housing, university, or dormitory purposes;

(2) Obligations of international and multilateral development banks and organizations listed in 12 U.S.C. 24 (Seventh);

(3) Other obligations listed in 12 U.S.C. 24 (Seventh) as permissible for a bank to deal in, underwrite, purchase, and sell for the bank's own account, subject to a limitation of 10 percent of the bank's capital and surplus; and

(4) Other securities the OCC deems eligible as Type II securities in accordance with 12 U.S.C. 24 (Seventh).

(j) *Type III security* means an investment security that does not qualify as a Type I, II, IV, or V security, such as corporate bonds and municipal revenue bonds.

(k) *Type IV security* means:

(1) A small business-related security as defined in section 3(a)(53)(A) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(53)(A), that is fully secured by interests in a pool of homogeneous loans to numerous obligors. The aggregate amount of collateral from loans of any one obligor may not exceed 5 percent of the total amount of collateral for the security;

(2) A commercial mortgage-related security that is offered or sold pursuant to section 4(5) of the Securities Act of 1933, 15 U.S.C. 77d(5), or a commercial mortgage-related security as defined in section 3(a)(41) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(41), that represents ownership of a promissory note or certificate of interest or participation that is directly secured by a first lien on one or more parcels of real estate upon which one or more commercial structures are located and that is fully secured by interests in a pool of homogeneous loans to numerous obligors. The aggregate amount of collateral from loans of any one obligor may not exceed 5 percent of the total amount of collateral for the security.

(3) A residential mortgage-related security that is offered and sold pursuant to section 4(5) of the Securities Act of 1933, 15 U.S.C. 77d(5), or a residential mortgage-related security as defined in section 3(a)(41) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(41)), and that does not otherwise qualify as a Type I security.

(l) *Type V security* means a security that:

(1) Is rated investment grade;

(2) Is not a Type IV security; and

(3) Is fully secured by interests in a pool of homogeneous loans (that a national bank could invest in directly) to numerous obligors. The aggregate amount of collateral from loans of any one obligor may not exceed 5 percent of the total amount of collateral for the security.

§ 1.3 Limitations on dealing in, underwriting, and purchase and sale of securities.

(a) *Type I securities.* A national bank may deal in, underwrite, purchase, and sell Type I securities for its own account. The amount of Type I securities that the bank may deal in, underwrite, purchase, and sell is not limited to a specified percentage of the bank's capital and surplus.

(b) *Type II securities.* A national bank may deal in, underwrite, purchase, and sell Type II securities for its own account, provided the aggregate par value of the obligations of any one obligor held by the bank does not exceed 10 percent of the bank's capital and surplus. This limitation applies to obligations that the bank is legally committed to purchase and sell in addition to existing holdings.

(c) *Type III securities.* A national bank may purchase and sell Type III securities for its own account, provided the aggregate par value of the obligations of any one obligor held by the bank does not exceed 10 percent of the bank's capital and surplus. This limitation applies to obligations that the bank is legally committed to purchase and sell in addition to existing holdings.

(d) *Type II and III securities; other investment securities limitations.* A national bank may not hold Type II and III securities of any one obligor with an aggregate par value exceeding 10 percent of the bank's capital and surplus. However, if the proceeds of each issue are to be used to acquire and lease real estate and related facilities to economically and legally separate industrial tenants, and if each issue is payable solely from and secured by a first lien on the revenues to be derived from rentals paid by the lessee under net noncancellable leases, the bank may apply the 10 percent investment limitation separately to each security issue of a single issuer of such securities.

(e) *Type IV securities.* A national bank may purchase and sell Type IV securities for its own account. The amount of the Type IV securities that a bank may purchase and sell is not limited to a specified percentage of the bank's capital and surplus. A national bank also may deal in Type IV securities that are fully secured by Type I securities.

(f) *Type V securities.* A national bank may purchase and sell Type V securities for its own account provided the aggregate par value of the obligations of any one obligor does not exceed 15 percent of the bank's capital and surplus. This limitation includes obligations the bank is legally committed to purchase and sell in addition to existing holdings.

(g) *Asset securitization.* A national bank may securitize and sell its loan assets as a part of its banking business.

The amount of securitized loans that a bank may sell is not limited to a specified percentage of the bank's capital and surplus.

(h) *Investment company shares.* A national bank may purchase and sell for its own account investment company shares, provided that the portfolio of the investment company consists wholly of securities and loans that the national bank may purchase and sell for its own account under this part, subject to the most stringent investment and/or lending limitation that would apply to the underlying securities or loans that comprise such company's portfolio.

(i) *Securities held based on estimates of obligor's performance.* (1) Notwithstanding § 1.2(e) of this part, a national bank may treat a debt security as an investment security for purposes of this part if the bank concludes, on the basis of estimates that the bank reasonably believes are reliable, that the obligor will be able to satisfy its obligations under that security, and the bank believes that the security may be sold with reasonable promptness at a price which corresponds reasonably to its fair value.

(2) The aggregate value of securities treated as investment securities under paragraph (i)(1) of this section may not exceed 5 percent of the bank's capital and surplus.

§ 1.4 Calculation of limits.

(a) *Calculation date.* For purposes of determining compliance with 12 U.S.C. 24 (Seventh) and this part, a bank's limitations shall be determined as of the most recent of the following dates:

(1) The date on which the bank's Consolidated Report of Condition and Income is properly signed and submitted;

(2) The date on which the bank's Consolidated Report of Condition and Income is required to be submitted; or

(3) When there is a change in the bank's capital category for purposes of 12 U.S.C. 1831o and 12 CFR 6.3.

(b) *Authority of OCC to require more frequent calculations.* If the OCC determines for safety and soundness reasons that a bank should calculate its investment limits more frequently than required by paragraph (a) of this section, the OCC may provide written notice to the bank directing the bank to calculate its investment limitations at a more frequent interval. The bank shall thereafter calculate its investment limits at that interval until further notice.

(c) *Calculation of Type III and Type V securities holdings.* In calculating the amount of its investment in Type III or Type V securities of any one obligor, a bank shall combine:

(1) Obligations of issuers that are related directly or indirectly through common control; and

(2) Securities that are credit-enhanced by the same entity.

(d) *Calculation of investment company holdings.* In calculating the amount of its investment in investment company shares under this part, a bank shall use reasonable efforts to calculate and combine its pro rata share of a particular security in the portfolios of each investment company with the bank's direct holdings of securities of that issuer.

§ 1.5 Safe and sound banking practices; credit information required.

(a) A national bank shall adhere to safe and sound banking practices and the specific requirements of this part in conducting the activities described in § 1.3. This includes appropriate consideration of the market, interest rate, credit, liquidity, legal, and operations and systems risks presented by a proposed activity. The bank's particular activities must be appropriate for that bank.

(b) In conducting these activities, the bank shall determine that there is adequate evidence that an obligor possesses resources sufficient to provide for all required payments on its obligations, or, in the case of securities deemed to be investment securities on the basis of reliable estimates of an obligor's performance, that the bank reasonably believes that the obligor will be able to satisfy the obligation.

(c) Each bank shall maintain records available for examination purposes adequate to demonstrate that it meets the requirements of this section. The bank may store the information in any manner that can be readily retrieved and reproduced in a readable form.

§ 1.6 Convertible securities.

(a) When a national bank purchases an investment security convertible into stock, or with a stock purchase warrant attached, the bank shall write down the carrying value of the security to an amount that represents the value of the security considered independently of the conversion feature or attached stock purchase warrant.

(b) A national bank may not purchase securities convertible into stock at the option of the issuer.

§ 1.7 Securities held in satisfaction of debts previously contracted; holding period; disposal; accounting treatment; non-speculative purpose.

(a) *Securities held in satisfaction of debts previously contracted.* The restrictions and limitations of this part, other than those set forth in paragraphs (b),(c), and (d) of this section, do not apply to securities acquired:

(1) Through foreclosure on collateral;

(2) In good faith by way of compromise of a doubtful claim; or

(3) To avoid loss in connection with a debt previously contracted.

(b) *Holding period.* A national bank holding securities pursuant to paragraph (a) of this section may do so for a period not to exceed five years from the date that ownership of the securities was originally transferred to the bank. The OCC may extend the holding period for up to an additional five years.

(c) *Accounting treatment.* A bank shall mark-to-market securities held pursuant to paragraph (a) of this section.

(d) *Non-speculative purpose.* A bank may not hold securities pursuant to paragraph (a) of this section for speculative purposes.

§ 1.8 Nonconforming investments.

(a) An investment in securities, which conforms to this part when made, will not be deemed a violation, but will be treated as nonconforming if the investment no longer conforms to this part because;

(1) The bank's capital declines;

(2) Issuers, obligors, or credit-enhancers merge;

(3) Issuers become related directly or indirectly through common control;

(4) The investment securities rules change;

(5) The security no longer qualifies as an investment security;

(6) The substitution of collateral by an issuer or trustee causes a Type IV or Type V security no longer to conform to the diversification requirements of §§ 1.2(k)(1) and (2) and 1.2(l)(3); or

(7) Other events identified by the OCC occur;

(b) A bank shall exercise reasonable efforts to bring an investment that is nonconforming as a result of events described in paragraph (a) of this section into conformity with this part unless to do so would be inconsistent with safe and sound banking practices.

Interpretations

§ 1.100 Indirect general obligations.

(a) *Obligation issued by an obligor not possessing general powers of taxation.* Pursuant to § 1.2(c) of this part, an obligation issued by an obligor not possessing general powers of taxation qualifies as a general obligation of a State or political subdivision for the purposes of 12 U.S.C. 24 (Seventh), if a party possessing general powers of taxation unconditionally promises to make sufficient funds available for all required payments in connection with the obligation.

(b) *Indirect commitment of full faith and credit.* The indirect commitment of the full faith and credit of a State or political subdivision (that possesses general powers of taxation) in support of an obligation may be demonstrated by any of the following methods, alone or in combination, when the State or political subdivision pledges its full faith and credit in support of the obligation.

(1) *Lease/rental agreement.* The lease agreement must be valid and binding on the State or the political subdivision, and the State or political subdivision must unconditionally promise to pay rentals that, together with any other available funds, are sufficient for the timely payment of interest on, and principal of, the obligation. These lease/rental agreements may, for instance, provide support for obligations financing the acquisition or operation of public projects in the areas of education, medical care, transportation, recreation, public buildings, and facilities.

(2) *Service/purchase agreement.* The agreement must be valid and binding on the State or the political subdivision, and the State or political subdivision must unconditionally promise in the agreement to make payments for services or resources provided through or by the issuer of the obligation. These payments, together with any other available funds, must be sufficient for the timely payment of interest on, and principal of, the obligation. An agreement to purchase municipal sewer, water, waste disposal, or electric services may, for instance, provide support for obligations financing the construction or acquisition of facilities supplying those services.

(3) *Refillable debt service reserve fund.* The reserve fund must at least equal the amount necessary to meet the annual payment of interest on, and principal of, the obligation as required by the applicable law. The maintenance of a refillable reserve fund may be provided, for instance, by statutory direction for an appropriation, or by statutory automatic apportionment and payment from the State funds of amounts necessary to restore the fund to the required level.

(4) *Other grants or support.* A statutory provision or agreement must unconditionally commit the State or the political subdivision to provide funds which, together with other available funds, are sufficient for the timely payment of interest on, and principal of, the obligation. Those funds may, for instance, be supplied in the form of annual grants or may be advanced whenever the other available revenues are not sufficient for the payment of principal and interest.

§ 1.110 Taxing powers of a State or political subdivision.

(a) An obligation is considered supported by the full faith and credit of a State or political subdivision possessing general powers of taxation when the promise or other commitment of the State or the political subdivision will produce funds, which (together with any other funds available for the purpose) will be sufficient to provide for all required payments on the obligation. In order to evaluate whether a commitment of a State or political subdivision is likely to generate sufficient funds, a bank shall consider the impact of any possible limitations regarding the State's or political subdivision's taxing powers, as well as the availability of funds in view of the projected revenues and expenditures. Quantitative restrictions on the general powers of taxation of the State or political subdivision do not necessarily mean that an obligation is not supported by the full faith and credit of the State or political subdivision. In such case, the bank shall determine the eligibility of obligations by reviewing, on a case-by-case basis, whether tax revenues available under the limited taxing powers are sufficient for the full and timely payment of interest on, and principal of, the obligation. The bank shall use current and reasonable financial projections in calculating the availability of the revenues. An obligation expressly or implicitly dependent upon voter or legislative authorization of appropriations may be considered supported by the full faith and credit of a State or political subdivision if the bank determines, on the basis of past actions by the voters or legislative body in similar situations involving similar types of projects, that it is reasonably probable that the obligor will obtain all necessary appropriations.

(b) An obligation supported exclusively by excise taxes or license fees is not a general obligation for the purposes of 12 U.S.C. 24 (Seventh). Nevertheless, an obligation that is primarily payable from a fund consisting of excise taxes or other pledged revenues qualifies as a ''general obligation,'' if, in the event of a deficiency of those revenues, the obligation is also supported by the general revenues of a State or a political subdivision possessing general powers of taxation.

§ 1.120 Prerefunded or escrowed bonds and obligations secured by Type I securities.

(a) An obligation qualifies as a Type I security if it is secured by an escrow fund consisting of obligations of the United States or general obligations of a State or a political subdivision, and the escrowed obligations produce interest earnings sufficient for the full and timely payment of interest on, and principal of, the obligation.

(b) If the interest earnings from the escrowed Type I securities alone are not sufficient to guarantee the full repayment of an obligation, a promise of a State or a political subdivision possessing general powers of taxation to maintain a reserve fund for the timely payment of interest on, and principal of, the obligation may further support a guarantee of the full repayment of an obligation.

(c) An obligation issued to refund an indirect general obligation may be supported in a number of ways that, in combination, are sufficient at all times to support the obligation with the full faith and credit of the United States or a State or a political subdivision possessing general powers of taxation. During the period following its issuance, the proceeds of the refunding obligation may be invested in U.S. obligations or municipal general obligations that will produce sufficient interest income for payment of principal and interest. Upon the retirement of the outstanding indirect general obligation bonds, the same indirect commitment, such as a lease agreement or a reserve fund, that supported the prior issue, may support the refunding obligation.

§ 1.130 Type II securities; guidelines for obligations issued for university and housing purposes.

(a) *Investment quality.* An obligation issued for housing, university, or dormitory purposes is a Type II security only if it:

(1) Qualifies as an investment security, as defined in § 1.2(e); and

(2) Is issued for the appropriate purpose and by a qualifying issuer.

(b) *Obligation issued for university purposes.* (1) An obligation issued by a State or political subdivision or agency of a State or political subdivision for the purpose of financing the construction or improvement of facilities at or used by a university or a degree-granting college-level institution, or financing loans for studies at such institutions, qualifies as a Type II security. Facilities financed in this manner may include student buildings, classrooms, university utility buildings, cafeterias, stadiums, and university parking lots.

(2) An obligation that finances the construction or improvement of facilities used by a hospital may be eligible as a Type II security, if the hospital is a department or a division of a university, or otherwise provides a nexus with university purposes, such as an affiliation agreement between the university and the hospital, faculty positions of the hospital staff, and training of medical students, interns, residents, and nurses (*e.g.*, a ''teaching hospital'').

(c) *Obligation issued for housing purposes.* An obligation issued for housing purposes may qualify as a Type II security if the security otherwise meets the criteria for a Type II security.

PART 7—INTERPRETIVE RULINGS

3. The authority citation for part 7 continues to read as follows:

Authority: 12 U.S.C. 1 *et seq.*, 93a.

§ 7.7570 [Removed]

4. Section 7.7570 is removed.

Dated: December 14, 1995.

Eugene A. Ludwig,

Comptroller of the Currency.

[FR Doc. 95–30969 Filed 12–20–95; 8:45 am]

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12 CFR Parts 9 and 19

[Docket No. 95–32]

RIN 1557–AB12

Fiduciary Activities of National Banks; Rules of Practice and Procedure

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC) proposes to revise its rules that govern the fiduciary activities of national banks. The OCC also proposes to relocate provisions concerning disciplinary sanctions imposed by clearing agencies to its rules of practice and procedure. This proposal is another component of the OCC's Regulation Review Program, which is intended to update and streamline OCC regulations and to reduce unnecessary regulatory costs and other burdens.

DATES: Comments must be received by February 20, 1996.

ADDRESSES: Comments should be directed to: Communications Division, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219, Attention: Docket No. 95–32. Comments will be available for public inspection and photocopying at the same location. In addition, comments may be sent by facsimile transmission to FAX number (202) 874–5274 or by electronic mail to REG.COMMENTS@OCC.TREAS.GOV.

FOR FURTHER INFORMATION CONTACT: Andrew T. Gutierrez, Attorney, Legislative and Regulatory Activities Division, (202) 874–5090; Donald N. Lamson, Assistant Director, Securities and Corporate Practices Division, (202) 874–5210; Lisa Lintecum, Director, Fiduciary Activities, (202) 874–5419; Dean Miller, Special Advisor, Fiduciary Activities, (202) 874–4852; Aida M. Plaza, Director for Compliance, Multinational Banking, (202) 874–4610.

SUPPLEMENTARY INFORMATION:

Background

The OCC proposes to revise 12 CFR part 9, which governs the fiduciary activities of national banks, as a component of its Regulation Review Program. One goal of the Regulation Review Program is to review all of the OCC's rules with a view toward eliminating provisions that do not contribute significantly to maintaining the safety and soundness of national banks or to accomplishing the OCC's other statutory responsibilities, including the oversight of national banks' fiduciary activities. Another goal of the Program is to improve clarity of the OCC's regulations.

This rulemaking is the OCC's first comprehensive revision of the rule since 1963.[1] Much about national banks' fiduciary business has changed since that time, including the nature and scope of the fiduciary services that banks offer and the structures and operational methods that banks use to deliver those services. The OCC's particular goal in revising part 9 is to accommodate those changes by lifting unnecessary regulatory burden and facilitating the continued development of national banks' fiduciary business consistent with safe and sound banking practices and national banks' fiduciary obligations. Three principal themes have emerged from the OCC's review of part 9.

First, bank organizational structures, particularly with respect to the geographic structure of banking organizations, have changed significantly since Congress created the basic framework for national banks' fiduciary operations. These changes strongly suggest that part 9 should be adjusted so that its requirements are more workable for both large, multistate fiduciary banking organizations and small banks that conduct fiduciary activities primarily on a local basis.

Second, national banks' fiduciary activities, in many respects, are subject to state law. In some cases, however, the OCC has the flexibility either to prescribe a uniform Federal standard or to direct national banks to follow state law.

Third, over the years, part 9 has been applied to a wide variety of investment advisory activities and related services, not all of which involve the bank's exercise of investment discretion. In some cases, banks engaged in these activities are subject to different standards than other types of entities that conduct the same type of business, raising the question of whether the OCC should narrow the range of investment advisory activities to which part 9 applies.

These three themes form the basis for requests for comment on specific provisions and issues described in detail in the remainder of this preamble discussion.

More generally, the proposal revises part 9 in its entirety. The proposal updates, clarifies, and streamlines part 9, incorporates significant interpretive positions, and eliminates unnecessary regulatory burden wherever possible to promote more efficient operation and supervision of national banks' fiduciary activities. The proposal adds headings for ease of reference, but, for the most part, retains the numbering system used in the current regulation. Commenters are invited to address all aspects of the proposal, including recommending further improvements to its organization, structure, and content.

Section-by-Section Description of the Proposal

Authority, Purpose, and Scope (Proposed § 9.1)

The proposal adds a new provision that explicitly sets forth the statutory authority for, and the purpose and scope of, part 9. In addition to standards found in part 9, the OCC provides guidance (including policies, procedures, precedents, circulars, and bulletins) regarding the fiduciary activities of national banks in the ''Comptroller's Handbook for Fiduciary Activities.'' The OCC currently is revising the guidance contained in the ''Comptroller's Handbook for Fiduciary Activities.'' The OCC anticipates that the revised fiduciary guidance will consist of a

[1] National banks have been authorized to exercise fiduciary powers since 1913. In 1962, the responsibility for the oversight of their fiduciary activities was transferred from the Board of Governors of the Federal Reserve System to the OCC. See 12 U.S.C. 92a. Following the transfer of oversight responsibilities, the OCC promulgated 12 CFR part 9 in 1962 (27 FR 9764), and revised it soon thereafter in 1963 (28 FR 3309).